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Editorial

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The JOURNAL of ACCOUNTANCY

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A. P. RICHARDSON, *Editor*

EDITORIAL

Significance of the O'Fallon Decision

Since the supreme court of the United States handed down its decision in what has become known as the O'Fallon case, every financial newspaper and magazine in the country has commented upon the substance of the court's decision. The question which seems to have attracted the most attention is whether the decision may lead to an increase in rates or not. Every public utility has a vital interest in the principles at issue in this celebrated case, but it does not appear that the essential point has to do with rates. It goes deeper than that. The decision, as accountants read it, justified the contention, which most accountants have long made, that the valuation of property can not be fairly based upon the cost alone. Common sense indicates that it is more nearly fair to say that the value of property is that amount of money which would be required if the owner of the property were called upon to reproduce it at the time of valuation. As a matter of fact, it seems quite ridiculous to say that assets acquired in a period of low prices, such as that which preceded the world war, should be valued at cost, when everyone knows that the cost of reproduction now would be two or three times as great. There were many collateral questions involved in the case of the St. Louis and O'Fallon Railway, an infinitesimal road which runs a total distance of nine miles. The very smallness of the property made it an excellent retort in which to test the justice and fairness of the valuation which the interstate commerce commission had been willing to allow the railroads. The case had hung fire for several years and meantime the great railroads had been waiting to see which way judgment would go. Now that the decision has been rendered there seems to be almost as much uncertainty as there was before, largely because the attention of writers and other commentators seems to have been directed to the question of rates.

**The Decision a
Compromise**

The decision is not an absolute, clear-cut dictum on the great question of cost valuation. In some ways it is remarkably like a compromise. For example, at one point in the decision the court says, "No doubt there are some, perhaps many, railroads, the ultimate value of which should be placed far below the sum necessary for reproduction." It seems, therefore, that the supreme court instructs the interstate commerce commission to walk in the middle of the road. It warns against walking on either side. It is unfair and unreasonable to fix the valuation at the figure of original cost and it may be unfair to fix the valuation at the present cost of reproduction new. It is now the difficult task of the interstate commission to find out the exact point at which the value should be placed. Some authorities have estimated that the difference between the two bases of valuation in the case of the railways of this country would approach twenty billions of dollars. If this guess is anywhere near the truth, every penny involved in the little O'Fallon railway has a significance of tremendous importance. The whole business structure of the country is so largely founded upon cheap and efficient transportation and other services rendered by public-utility companies that the question of what shall be allowed as reasonable return upon investments in the case of such companies interests every business man. It seems to some critics rather a pity that the supreme court could not lay down a fixed rule which would apply to the valuation of all properties. Indeed it is a pity that many perfect things are still unaccomplished. It may be fitter to ask what could have been put forward by the supreme court which would meet the requirements in all cases. Men who have devoted their lives to the study and practice of accountancy are quite aware of the impossibility of making rigid rules for the determination of values. There are so many factors which might enter into the value of a public-utility company's property that he would be foolhardy who would attempt to make the decision by any rule of thumb. The most that can be accomplished is an approximation. In the O'Fallon case the supreme court has given a hint as to method, but not much more. The importance of the decision lies not in its precision but rather in its counsel of moderation. Many people believe that the interstate commerce commission in the past has been somewhat inclined to lay down rules and to stick to them because they were laid down. The

commission has been slightly unyielding, or perhaps stubborn, and it is gratifying to know that the highest authority of the land demands a middle course. The questions of rates, investment values and other related subjects will be answered by process of time. No one can foresee precisely what will be decided in the case of any one railway or group of railways. At present the country may congratulate itself that the absurd theory that cost of original production is cost for all time has been killed.

**Slandering the
Bankers**

A correspondent, whose word heretofore has always been credible, makes the astounding statement that certain banks have neglected to give him confirmation of securities in transfer which he required in order to certify to the accounts of a brokerage concern. The correspondent says that he has completed his work but is unable to render his report until the desired information can be obtained. He even goes to the absurd extreme of saying that some banks make a charge for confirmations and that some others have absolutely refused to confirm. Of course, all this is utter nonsense. We know from years of experience, from the utterances of countless bankers and from a mass of correspondence which is overwhelming, that no banker would do anything to interfere with the progress of an audit. It is upon the audit that the banker most relies and it is his chief ambition in life to assist by all the means in his power the most searching thoroughness in all that an auditor does. The statement that some banks make a charge for confirmation is insulting to all bankers. Such avarice is inconceivable. It is unfortunate that the correspondent who makes these unfounded charges desires to remain anonymous and refuses to permit publication of the names of banks which he accuses. As we have said, the man is an honest man and bears a good reputation in a somewhat discriminating community, but he does not wish his name to be known now—he merely reports what he describes as a fact and hopes that someone can do something about it.

**Why Hide the
Truth?**

Suppose, merely for the sake of argument, that there were any truth in these outrageous charges. It now becomes of interest to inquire—as a matter of pure speculation—what could animate any banker who would refuse to assist

the search for truth. Has the accountant's certificate no more significance than the name of the accountant? We have heard of bankers who are said to have said that they never read a certificate but depend solely upon the general reputation of the signer. For such a banker our correspondent might render a report saying that nothing had been verified and that he could not do more than express a faint and unfounded hope that all was well. If his name were appended that would satisfy such a banker. But, naturally, one can not believe that there are bankers of that sort. Every meeting of bankers is vocal with virtuosity. The bankers are the great truth seekers and when the more or less humble lawyer or accountant comes along and seeks information it must be supplied, fully, frankly and without prejudice. To come to the instant case, how could the audit of a brokerage concern have value if there were nothing to indicate the accuracy of the records of securities in transfer? In a market so active as that we have today, the value of securities in transfer is colossal. That one item in the accounts of many brokerage concerns is the most important of all. But why tilt at windmills? Our correspondent may say if he will that three of the largest trust companies in the city of New York refuse to confirm. It is incredible.

Yet Another Banker Instructs the Accountant

As a further proof that bankers are increasingly dependent upon the thoroughness of accountants' work, it may be appropriate to draw attention to the opinion of "a prominent banker" which appears in the *Bulletin* of the American Institute of Accountants, dated June 15, 1929. This banker is reported to have written:

"With reference to your inquiry, I believe the verification of inventories by accountancy firms undertaking audit work to be absolutely essential, and that the responsibility of the accountancy firm is thus established, and it is not to be excused where a balance-sheet is qualified upon the certificate of the client as to the correctness of the inventories, and accepted by the accountancy firm without due and proper verification, and that the entire audit might just as well be foregone with the inventory verification omitted. We have always felt that accountancy firms engaged in undertaking the audit work of our clients should verify the inventories and accept full responsibility therefor by setting forth in the balance-sheet submitted a classification of the merchandise stock together with a report upon the condition of all inventories. Naturally it is to be admitted that the accountancy firm does not furnish technical experts in the valuation of merchandise stocks, and in some instances must rely upon the knowledge and ability of the client or his personnel to do so. With this exception as to the condition of valuation, we believe that accountancy firms should accept full and unreserved responsibility for the verification of all the items

reflected by their statements and particularly with reference to the verification of inventories."

**Nothing Short of
Omniscience Will Do**

On the same page appears a letter from the president of a department store, who thoroughly endorses the opinion of the banker that the accountant should assume responsibility for physical count and valuation of inventory. There are very few accountants, we believe, who would subscribe to such a theory, but it is a rather popular notion among bankers that if possible the accountant should be made to assume the burden of responsibility. Now, of course, it is impossible for any accountant to know everything, whatever an accountant here or there may think about it. Even if there were an omniscient practitioner of accountancy, probably no one would believe in him. The man who could honestly certify to the absolute accuracy of the count and valuation of the stock of a jeweler and the stock of a steel corporation would be an abler person than the world has yet known. It is merely silly to profess ability to value and to count everything on earth. Accountants are called upon at one time or other to review the accounts of companies engaged in producing, manufacturing and selling every known article of trade. In some cases, as everyone knows, the merchandise can be counted and perhaps valued. These are rare cases, and the banker who demands that the accountant shall assume responsibility for the accuracy of inventory, except in the most general way, is unwise in his day and generation. The accountant who accepts the responsibility is still more unwise. This is an old subject and has no particular importance at the moment, but it is noteworthy as an illustration of the desire of the banker that the accountant shall know everything and is a total refutation of the allegation that any banker would withhold proper information.

**The Merry Life
of an Examiner**

The examiners for the American Institute of Accountants report an unusual number of delightful answers to questions at the examinations held in May this year. In the examination in auditing there seems to have been exceptional brilliance. One candidate, in response to a question as to procedure, says, "First of all not being familiar with such a company, I would ask questions of the employees as to transactions (yet not letting them know how little I knew)." That candidate should take up

politics. Another defines a subsidiary corporation as "an invisible individual organized under state statute." And another says that "a close corporation is one that does not make public all its affairs." A rising financier in the field of accountancy, in reponse to a question as to the advice which he would give to officers of a financial organization involving investment of large funds, replied that he would advise the corporation to sell out all its present investments and to put its money into something he could recommend. A holding company is defined as one which "holds all the assets, but has nothing to do with the operating end of the business." This answer might have been written by one who had been reading too many text books. A candidate, describing his procedure in the audit of a bank, says that he would "call a meeting of the directors and examine them under oath for any unusual transactions." This sounds something like a clinic. And another candidate, answering the same question, says that he would "take actual physical possession at once of all cash, notes, collateral, customers' accounts, open accounts and savings accounts." He does not say where he would go with them. A young man who has given thought to the problem of a bank audit has devised a new method. He says in his examination paper that "if there is a large number of auditors they should wear buttons in their lapels." This is evidently a mere fashion note. The life of the examiner is really a merry one and full of pleasant incidents. For example, think of having to read and interpret the following sentence: "The accompanying working papers were first conceived; however, in filling it in obvious discrepancies loomed and in the balance-sheet I have omitted the subscription accounts for even though all of the preferred stock holders have not surrendered any of their stock; likewise some of the common stock holders, there is nothing in the problem to indicate that they will not do so. They may not have had time to do it by March 31, 1929, as it takes time to call in certificates." And yet candidates sometimes wonder that they do not pass the examinations.

**Committee on
Terminology**

The next article on accounting terminology, supplied by the committee on terminology of the American Institute of Accountants, will probably appear in the August issue of THE JOURNAL OF ACCOUNTANCY. The committee is now engaged in correcting for the printer the proofs of definitions prepared by it,

which are to be published in pamphlet form. The work is progressing well, but the committee has expressed the hope that members of the Institute and other accountants will send in suggestions as soon as possible. The committee desires to add all purely accounting terms that have not already been published. The definitions which have been printed from time to time in *THE JOURNAL OF ACCOUNTANCY* are to constitute the greater part of the forthcoming pamphlet. If any reader can think of terms which have not been defined but should be defined, the committee will be thankful for suggestions.

**Arkansas Falls
from Grace**

There was occasion not long ago to speak in terms of strong commendation of an act passed by the legislature of Arkansas with reference to income taxation and the recognition of the part which the public accountant plays in the preparation of tax returns. It is, therefore, all the more distressing to have to record the passage of what seems to be an altogether undesirable act by the same legislature. A bill, introduced in this year's session of the Arkansas legislature became act No. 167, "To authorize the employment of certified public accountants to audit continuously the books and records of the state highway commission." In brief, this act provides that the governor, the secretary of state, the attorney-general, the state treasurer and the state auditor are authorized and directed to contract with three "licensed firms" of certified public accountants to furnish the services of one "auditing accountant" each to the state for the purpose of auditing the affairs of the state highway commission. Contract price for services is not to exceed \$325 a month and expenses. Contracts are to run for a period of two years but no "individual auditor shall serve as an auditor . . . two consecutive years—the intent being that all auditors would be changed once a year." The contracts are to provide that the three auditors engaged shall formulate a working agreement and the reports shall be signed by the three auditing firms as "associated certified public accountants." There are other sections of the act which are almost equally ridiculous but not important. Fortunately for the good name of Arkansas, the state board of accountancy took action and issued a statement which deserves quotation in full:

"It appears that the board authorized by act No. 167, passed by the general assembly of the state of Arkansas, has intimated in an article in the

Arkansas Gazette, April 14, it will continue to attempt to secure the services of certified public accountants for an audit of the highway department.

"The state board of accountancy, after duly considering act No. 167 from all angles, must place its disapproval upon the act and upon the carrying out of the provisions of such act by certified public accountants.

"In the general nature of accountancy and the duties of one certified public accountant to another and to the profession, it is unethical for a certified public accountant to engage in this work.

"Rule No. 6 of the rules of professional conduct, as promulgated by the American Institute of Accountants, reads in part:

"No member or associate shall certify to any accounts, exhibits, statements, schedules or other forms of accountancy work which have not been verified entirely under the supervision of himself, a member of his firm, one of his staff, or a member or an associate of this institute."

"We feel certain that no member of the legislature which passed this act, if he were ill, would desire to employ three physicians to prescribe for him jointly; nor, if he had a bad tooth, would he want three dentists to work on it at the same time. The certified public accountant is to the business world what the physician and the dentist is to the personal world, with this proviso—that he is usually called in before the business' illness becomes acute.

"Analyzing act No. 167, it appears that the highway commission is very desirous of having its accounts verified by members of the accounting profession and, assuming that this desire, as set forth in the preamble to act No. 167 was sincere, it would appear that a proper measure should have been taken to have had a complete and intelligent analysis of the activities of the highway commission, since the inception of the Martineau road law, made by a firm of certified public accountants of recognized ability who are amenable to the state accountancy act.

"As before said, if the highway commission is sincere in the preamble to act No. 167, it would appear that arrangements should be made to have an analysis made of the activities of the highway department by a single firm of certified public accountants on the basis of a regular audit.

"The ramifications of the work of the highway department are such that the firm engaged in this service would have to include as part of its staff engineers of recognized ability and one or more of the legal profession to interpret some of the items which would have to be analyzed."

There does not seem to be much that can be added to the arguments adduced by the president and the secretary of the state board of accountancy. They might have added something about the apparent effort to create a super-firm to be known as "Associated Certified Public Accountants." That proposal seems to call for passing notice, but the serious part of the whole plan is that the act indicates a total absence of knowledge of what constitutes the duty of a professional man. Rumor reaches us that the accountants of Arkansas are not inclined to accept the contracts which are authorized by the new law. Some time ago we suggested that the answer to the problem of bidding was abstinence from bidding. If no one would offer his services in response to advertisement or other attempt to obtain bids, another method would be found. Apparently the Arkansas accountants have a similar notion, and if, as it is reported, they refuse participation in

all such absurdities as the new highway act would perpetrate, reform will be achieved.

**The Institute's
Employment Exchange**

Readers of the *Bulletin* of the American Institute of Accountants are familiar with the employment exchange which was added last summer to the long list of the Institute's activities. It was begun as an experiment, but although it has been conducted on a very small scale, it has been of service in a number of instances. As long as it appears to be desired by the membership it will probably be continued. The procedure is simple. Applicants for staff positions are requested to submit appropriate information on a registration card. The Institute makes no investigation of applicants' records, but merely relays information to firms which request it. Each applicant who is not a member or an associate is interviewed by a member before his application is accepted. The qualifications of several typical applicants are published, without names, in the *Bulletin*, and firms in need of men indicate the kind most suitable for their purposes. Firm and applicant are put in communication with each other—and there the Institute's participation ends. No fee has been charged for the service. In general the applicants who have availed themselves of the service have been desirable, and some firms have been much pleased with the men referred to them. Several members of the Institute, who wished to move to new vicinity, have welcomed the opportunity to undertake negotiations with possible employers through the confidential channel afforded by the exchange. This new venture must not be confused with the bureau for placements, which supplies college graduates as junior assistants. The employment exchange does not undertake to assist inexperienced juniors. Its service is available only to men who have had public accounting experience. There seems to be a real need in the profession for machinery to assist firms in dealing with the vital question of staff personnel, and the employment exchange is an attempt to meet that need.